

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

CARL E. ANDREWS

CASE NO. 95-62796

Debtor

JAMES HOVANEK and
MARGARET HOVANEK

Plaintiffs

vs.

ADV. PRO. NO. 95-70231A

CARL E. ANDREWS

Defendant

APPEARANCES:

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Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT,
CONCLUSIONS OF LAW AND ORDER

This proceeding is before the Court upon the complaint of James Hovanec and Margaret Hovanec ("Plaintiffs"), filed on November 3, 1995. The Plaintiffs seek to deny Carl E. Andrews ("Debtor") a discharge pursuant to § 727(a)(4) and (5) of the Bankruptcy Code (11 U.S.C. §§

101-1330) (“Code”). Issue was joined by the filing of an answer on behalf of the Debtor on November 15, 1995.

The trial of the adversary proceeding was originally scheduled to be heard on April 19, 1996, and was subsequently adjourned several times with the consent of the parties. On January 17, 1997, a trial was held in Utica, New York. In lieu of closing arguments, the Court afforded the parties an opportunity to file memoranda of law. The matter was submitted for decision on February 24, 1997.

JURISDICTIONAL STATEMENT

The Court has core jurisdiction over the parties and subject matter of this adversary proceeding pursuant to 28 U.S.C. §§ 1334(b), 157(a), (b)(1) and (b)(2)(J).

FACTS

In connection with the adversary proceeding herein, the parties have stipulated to the following facts:

1. On September 24, 1991, Hovanec Builders and Development Corp. (“HBDC”) transferred title to a parcel of real property known as 1138 Oberon Drive, King Ferry, New York (“Oberon Bluff Property”) to the Debtor and his wife, Susan N. Andrews (“Mrs. Andrews”).
2. On July 8, 1992, the Tompkins County Trust Company (“Tompkins County Trust”) obtained a mortgage lien against the Oberon Bluff Property to secure an indebtedness owed by

Debtor and his wife.

3. On December 17, 1993, Debtor conveyed all of his right, title and interest to the Oberon Bluff Property to his wife by way of a warranty deed with lien covenant.

4. On or about September 13, 1995, the Tompkins County Trust recorded a release of the mortgage lien on the Oberon Bluff Property in the Cayuga County Clerk's office.

5. On September 30, 1986, Henry and Erna M. Bahr conveyed all their right, title and interest to a parcel of real property located in Halstead, Pennsylvania ("Pennsylvania Property") by way of deed recorded in the Susquehanna County Deed Book 440 at page 523 to Debtor and his wife.¹

6. On January 18, 1994, Debtor conveyed all of his right, title and interest to the Pennsylvania Property to Mrs. Andrews by way of a deed recorded in the Susquehanna County Deed Book 511 at page 588. *See* Plaintiffs' Exhibit 7.

7. On or about March 28, 1995, Peoples National Bank of Susquehanna County ("Peoples National") refinanced an indebtedness secured by a mortgage lien on the Pennsylvania Property. The balance at the time of refinancing was approximately \$46,000.

8. To date title to the Pennsylvania Property has remained with Mrs. Andrews.

See Trial Stipulation of Facts, filed January 17, 1997.

On August 9, 1995, the Debtor filed a voluntary petition ("Petition") pursuant to chapter 7 of the Code. On page 3 of the Petition, in response to a request that the Debtor identify all other names he had used in the last six years, there appears the following:

¹At the trial there was testimony to the effect that the Debtor and his wife were not married at the time of the transfer of the Pennsylvania property in 1986.

AND AN OFFICER OF ANDREWS HOMES, INC.²
STOCKHOLDER AND OFFICER OF HOVANEC BUILDERS & DEVEL CORP.

According to the Summary of Schedules accompanying the Petition, Debtor's assets totaled \$91,860. He also listed liabilities totaling \$290,146.25, including \$5,000 in secured debt. *See* Plaintiffs' Exhibit 1. Plaintiff, James Hovanec, is listed as an unsecured creditor with a claim in the amount of \$8,186 identified as a "corporate debt." Margaret Hovanec is not listed as a creditor.

On November 3, 1995, Plaintiffs filed a complaint pursuant to Code § 727(a)(4), alleging that the Debtor had failed to list three mortgages on Schedule D and had also failed to list the monthly mortgage payments on Schedule J as expenses.³ Plaintiffs in their complaint also assert that the Debtor "failed to disclose in his schedule of affairs that he was within the two years last past the sole shareholder, sole director and president of Hovanec Builders and Developers Corp. and was the president of Andrews Homes, Inc." *See* ¶ 18 of the Complaint.

In their complaint, Plaintiffs also allege, pursuant to Code § 727(a)(5), that Debtor failed to satisfactorily explain the loss of assets. Specifically, Plaintiffs direct the Court to a Personal Finance Statement filed by Debtor on November 17, 1992 ("1992 Statement"), in which he listed \$35,000 in personal property, including furniture, jewelry, etc. *See* Plaintiffs' Exhibit 4.

²According to the testimony, Debtor served as president of Andrews Homes, Inc., a corporation formed for the purpose of allowing the Debtor to enter into a franchise agreement for the sale of Viceroy Homes. Mrs. Andrews testified that although she was named as the principal shareholder, the corporation "never got off the ground," and she never participated in any formal meetings of the corporation.

³On November 30, 1995, the Debtor filed an Amended Schedule D, listing three mortgages totaling \$258,000, increasing his total liabilities to \$548,146.25. *See* Plaintiffs' Exhibit 2.

According to Schedule B, accompanying Debtor's Petition, Debtor listed ownership in \$1,500 in household goods and furnishings and \$300 in wearing apparel as of July 24, 1995, the date the Debtor actually signed his Petition.

According to the Statement of Financial Affairs filed with the Petition, Debtor was employed as a general contractor from 1975 through December 1994. At the trial, Debtor testified that sometime prior to 1992 he became sole shareholder, director and president of HBDC, positions he continued to hold until sometime in December 1994. HBDC was involved in mostly residential construction. Debtor testified that he estimated that HBDC generated gross revenues of approximately \$2,000,000 in 1992; \$1,695,000 in 1993, and \$1,000,000 in 1994. He also indicated that no tax returns had been filed on behalf of HBDC in 1994 because the corporation was going out of business. According to Schedule I, Debtor was collecting unemployment in the amount of \$1,300 per month at the time the Petition was filed. His expenses totaled \$570 per month. *See id.*

Debtor listed as his address on his Petition the Oberon Bluff Property. According to Mrs. Andrews, she and the Debtor resided there until approximately February 1995, at which time it appears that they moved to 1575 Dryden Road, Freeville, New York ("Dryden Road").⁴ Debtor

⁴There was no evidence presented to indicate that the Debtor ever held title to the property at Dryden Road. In connection with the sale of a portion of the property in February 1995, Debtor was given the first right to build homes on the property in the event the purchaser decided to develop the acreage. Both Debtor and Mrs. Andrews explained that the stipulation had been included in the sale contract in the hopes of dissuading the purchaser from going ahead with the contract once it was learned that he intended initially to clear the property of timber. There was also testimony from David Hemke ("Hemke"), a real estate broker who met with the Debtor and Mrs. Andrews in July 1995 about listing the Dryden Road Property. At the completion of Plaintiffs' direct questioning of Hemke, Debtor's counsel moved to strike the testimony on the basis of relevancy. The Court concludes that any involvement Debtor may have had in assisting Mrs. Andrews in the sale of the Dryden Road Property is irrelevant to the matter herein and will

testified that approximately three months prior to filing his Petition, he was actually residing in Baltimore, Maryland with a friend while he looked for employment, returning to Dryden Road on weekends. As of January 8, 1996, he resided in New Cumberland, Pennsylvania, and as of the date of the trial he stated that he resided in Enola, Pennsylvania. Debtor testified that he was currently employed as a program analyst for International Business Machines.

It was in February 1995 that some of the Andrews' personal property was sold through the services of Glenn H. Munson & Sons Auctioneers ("Auctioneer"). *See* Plaintiffs' Exhibit 15. According to various checks received from the Auctioneer, Debtor received approximately \$1,570 from the sale of personal property between February 17, 1995 and June 16, 1995. *See id.* Debtor also testified that some of their neighbors had been allowed to take items from the Oberon Bluff Property. On direct questioning by Plaintiffs' attorney, Debtor indicated that the \$35,000 figure in the 1992 Statement was an estimate calculated by assigning a figure of \$3,000 for each room of furniture and multiplying it by two houses. He also explained that the \$35,000 included personal property owned by both himself and Mrs. Andrews and that some of the items, such as jewelry and furniture, were currently in her possession.

Debtor testified that the Pennsylvania Property had been listed for sale the second half of 1995 at \$149,000, but was then taken off the market in December 1995 after an offer of \$144,000 "fell through." Approximately \$102,000 was owed on first and second mortgages as of November, 1995. *See* Plaintiff's Exhibit 2. It was Debtor's testimony that the Pennsylvania Property had been transferred to Mrs. Andrews in January 1994 in repayment for monies advanced to HBDC from their joint account and also to offset an equity loan utilized to pay

not be considered by the Court.

corporate expenses.⁵ Mrs. Andrews testified that there had been many occasions when she had provided monies to the Debtor for use in the business. It was her testimony that there were no written records to establish the amount of the alleged indebtedness or the reduction of it following the transfer of the real property. Approximately \$90,000 of their personal money had also be utilized to purchase the corporation. *See* Plaintiffs' Exhibit 16 at 50. Debtor testified that the transfer of the real property was also made for purposes of estate planning. He explained that he had other children by a prior marriage who he felt might dispute rights to the real property in the event of his death. Both he and Mrs. Andrews wanted to be sure that in the event they both died that their four year old son would inherit the real property.

With respect to the Oberon Bluff Property transferred to Mrs. Andrews in December 1993, Debtor testified that it was subsequently transferred back to Tompkins County Trust in lieu of foreclosure after having been on the market for two years. As was stipulated by the parties, a release of the mortgage lien on the Oberon Bluff Property was recorded in the Cayuga County Clerk's office on September 13, 1995. It was the Debtor's testimony that it eventually was sold by the bank for approximately \$140,000 and that they owed approximately \$165,000 at the time it was transferred to the bank.

Debtor testified that he did not list the mortgages on either property in his original schedules because of his concerns for his wife and the financial stress they had been experiencing. At the time that he filed his Petition he was not living with his wife. However, at the time of the trial the two have neither legally separated nor divorced. It was Debtor's

⁵Mrs. Andrews was listed in the Petition as holding an unsecured claim in the amount of \$14,000.

testimony that he did not think it was any “big deal” to omit the mortgage debts to Tompkins County Trust and People’s National from his list of liabilities and his list of expenses since his wife was paying them. He did acknowledge that he had a legal obligation to pay them, however, since his name was on the mortgages as a co-borrower. He testified that at the time he signed his Petition he did not recognize the significance of the omission and upon the advice of his attorney he later amended Schedule D. It was his testimony that he simply did not want the banks calling his wife and threatening to foreclose on the real property because of his bankruptcy.⁶

DISCUSSION

One of the primary purposes of the Bankruptcy Act is to ‘relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortune.’

Local Loan Co. v. Hunt, 292 U.S. 234, 244, 54 S.Ct. 695, 699, 78 L.Ed. 1230 (1934) (quoting *Williams v. United States Fidelity & Guaranty Co.*, 236 U.S. 549, 554-555, 35 S.Ct. 289, 290, 59 L.Ed. 713 (1915)). With the idea of affording a deserving debtor this “fresh start,” objections to discharge under Code § 727 are to be strictly construed against the creditor and liberally in favor of the debtor. *In re Gannon*, 173 B.R. 313, 316 (Bankr. S.D.N.Y. 1994) (citations omitted). Plaintiffs must establish the elements of a cause of action by a preponderance of the evidence. *See In re Martin*, 208 B.R. 799, 805 (N.D.N.Y. 1997); *Gannon*, 173 B.R. at 317 (citing *Nisselson*

⁶Debtor acknowledged on cross-examination by his attorney, following Plaintiff’s direct examination, that he had not given any thought to the fact that he had listed Tompkins County Trust in his Petition as a creditor with respect to a car loan, thereby giving the bank notice of his bankruptcy.

v. Wolfson (In re Wolfson), 139 B.R. 279, 282-285 (Bankr. S.D.N.Y. 1993), *aff'd* 152 B.R. 830 (S.D.N.Y. 1993)).

In order to sustain an objection to discharge under Code § 727(a)(4), the Plaintiffs must prove (1) the Debtor made a statement under oath; (2) the statement was false; (3) the Debtor knew the statement was false; (4) the Debtor made the statement with fraudulent intent; and (5) the statement related materially to the bankruptcy case. *See Martin*, 208 B.R. at 805; *In re Hogan*, 193 B.R. 130, 140 (Bankr. N.D.N.Y. 1995) (citations omitted).

The Debtor's Petition and Schedules constitute statements made under oath for purposes of a cause of action based on Code § 727(a)(4). *See Martin*, 208 B.R. at 805-806; *In re Baker*, 205 B.R. 125, 131 (Bankr. N.D.Ill. 1997) (citations omitted). Thus, Plaintiffs have established that the Debtor made certain statements under oath.

Plaintiffs must also establish that the statements were false. In this case, Debtor's listing of only \$5,000 in secured debt was false since he failed to also include the mortgage obligations on both the Pennsylvania Property and the Oberon Bluff Property. The fact that he later amended Schedule D does not make the Debtor's original statement any less false. *See Gannon*, 173 B.R. at 320.

Plaintiffs also assert that the Debtor made a false statement in failing to identify his role as an officer, director and shareholder in HBDC and an officer in Andrews Home, Inc. in response to Question 16 of the Statement of Financial Affairs. Although the question asked that he list the name of any business with which he was associated, *inter alia*, as an officer or director in the two year period prior to filing his Petition, Debtor listed his own name and the fact that he operated as a general contractor from 1975 to December 1994. In responding to Question 16,

Debtor made no reference to either corporation by name.

While he failed to properly respond to Question 16, the Court finds that there was sufficient information in the Petition to alert the trustee and/or creditors of a prior relationship with the two corporations. For example, on page 3 of his Petition he indicates that he was an officer of Andrews Homes, Inc. and a stockholder and officer of HBDC. Also, in Schedule “B” Debtor lists an interest in stock of HBDC and that he was owed \$90,000 by HBDC based on an alleged loan to the corporation. Furthermore, with the exception of a few credit card debts, all of the unsecured nonpriority claims are identified as corporate debt. Therefore, the Court finds that with respect to his role in HBDC and Andrews Homes, Inc., the fact that the information was not included in Question 16 of the Statement of Financial Affairs does not lead the Court to the conclusion that the Debtor made a false oath in that regard in light of the other disclosures in his Petition and Schedules.

With respect to the third element, which requires a showing that the Debtor knew the statement was false, the Debtor admitted on direct questioning by Plaintiffs’ counsel that he knew that he was legally obligated on the mortgages. It was his testimony that he felt it unnecessary to list the mortgages, however, since Mrs. Andrews was making the payments.

The fourth element requires that the Plaintiffs establish that Debtor’s omission of the mortgages from his Schedules was done with fraudulent intent. “The existence of fraudulent intent is a question of fact, and the creditor bears a considerable burden in demonstrating such intent.” *Martin*, 208 B.R. at 806 (citation omitted). The question is whether Debtor willfully made the false statement with the intent to defraud his creditors. *See In re Bodenstein*, 168 B.R. 23, 32 (Bankr. E.D.N.Y. 1994) (citation omitted). “[A] reckless disregard of both the serious

nature of the information sought and the necessary attention to detail and accuracy in answering may rise to the level of fraud.” *Gannon*, 173 B.R. at 320 (quoting *In re Bailey*, 53 B.R. 732, 735 (Bankr.W.D.Ky. 1985)) (emphasis added).

In addressing the issue of intent, Plaintiffs rely on the case of *In re Silverstein*, 151 B.R. 657 (Bankr. E.D.N.Y. 1993) and assert that “[t]he identical facts of the case at bar compel the same conclusions here.” *See* Plaintiffs’ Supplemental Memorandum Regarding Section 727(a)(2)(A), filed February 24, 1997, at 4. Plaintiffs argue that the Debtor’s omission of the three mortgages were “in furtherance of the Debtor’s plan to conceal major assets from his creditors . . .”. *See id.*

The facts in *Silverstein* are, to a certain extent, remarkably similar to the case *sub judice*. In *Silverstein* the debtor transferred his one-half interest in his residence to his wife without consideration some 18 months prior to filing his petition. The debtor continued to occupy the residence and also continued to pay the mortgage, taxes and maintenance from the couple’s joint checking account. The debtor failed to list his interest in the real property or his obligation on the two mortgages in his petition and schedules. He later amended his schedules to reflect those facts after the plaintiff commenced the adversary proceeding. At about the same time that the deed transferring his interest to his wife was recorded, the debtor sold a half interest in a corporation in which he was the sole shareholder to the plaintiff. A year later the corporation ceased its operations and the debtor filed a chapter 7 petition. The court’s discussion on the issue of fraudulent intent focused for the most part on Code § 727(a)(2)(A) and whether the alleged transfer of property to debtor’s wife had been with an intent to defraud creditors. The court examined certain “badges of fraud” and concluded that the reason for the transfer had been to

“remove his major asset from the reach of his creditors while retaining all the benefits of ownership during a period when he believed the financial condition of his business might deteriorate further.” *See id.* at 662. The court only briefly addressed Code § 727(a)(4)(A) and concluded that the debtor’s intent was to “further his plan to conceal an equitable interest in his home.” *See id.*

In the matter presently before the Court, there is no cause of action asserted against the Debtor pursuant to Code § 727(a)(2)(A) alleging a fraudulent transfer of property. The focus of the Court’s inquiry is primarily on the statements made by the Debtor under oath in his Petition and Schedules. However, it appears that Plaintiffs would have the Court draw certain inferences of a fraudulent intent based on the transfers of real property to Mrs. Andrews approximately 18 months prior to the filing of the Debtor’s Petition.

Unlike the case in *Silverstein* in which the court concluded that the debtor retained an equitable interest in the residence based on the fact that he had never permanently moved out of the residence and had continued to pay the mortgage, taxes and maintenance on the property, the Debtor herein apparently was not residing at the Oberon Bluff Property or the Pennsylvania Property at the time he filed his Petition. Despite the fact that his Petition lists his residence as the Oberon Bluff Property, Debtor testified that he was residing in Baltimore, Maryland at the time⁷ and returning to the Dryden Road Property on weekends. Indeed, approximately a month after the Debtor filed his Petition, Mrs. Andrews deeded the Oberon Bluff Property to Tompkins County Trust in lieu of foreclosure after she was unable to sell the property and also apparently

⁷No motion has been made in the case pursuant to Rule 1014 of the Federal Rules of Bankruptcy Procedure alleging improper venue and requesting that the case be transferred to another district.

was unable to make the mortgage payments. Tompkins County Trust recorded a release of its mortgage lien on September 13, 1995. Debtor testified that Mrs. Andrews has rented out the Pennsylvania Property in the past and continues to pay the mortgage herself. Debtor also acknowledged that he and his wife claimed the interest on the mortgage payments as a deduction on their joint tax returns. However, there was no evidence presented that clearly demonstrates that the Debtor has retained any sort of equitable ownership in the Pennsylvania Property. What he did retain, however, was a legal obligation to pay the mortgage in the event of a default by Mrs. Andrews.

In this case, the Court concludes that Debtor's omission of the mortgages was done with knowledge but without fraudulent intent. While the Debtor may have demonstrated a reckless disregard for the serious nature of the information concerning his obligation on the three mortgages, the Court concludes that his failure to list them in his Schedules does not rise to the level of fraud. Furthermore, there was no evidence of a "multitude of discrepancies, falsehoods and omissions" as was the case in *In re Sapru*, 127 B.R. 306, 315-316 (Bankr. E.D.N.Y. 1991). *See also Martin*, 208 B.R. at 806 (finding several "badges of fraud" evidencing fraudulent intent). The fact that the Debtor failed to list the three mortgages on the two properties in and of itself is simply not sufficient to meet Plaintiffs' "considerable burden" in establishing fraudulent intent. Plaintiffs failed to elicit evidence of any other discrepancies or omissions that would convince the Court that the Debtor was not entitled to a discharge.⁸

⁸Plaintiffs' counsel sought to admit a deposition dated August 23, 1994, in connection with a separate matter litigated in state court, and also two credit line agreements secured by the Pennsylvania Property on the basis that Debtor had failed to respond to a Notice to Admit, allegedly dated March 13, 1996 (Plaintiffs' Exhibits 8, 9 and 17). Although the Notice to Admit was not filed with the Court, Debtor's counsel did not deny having been served with the request.

Since the Court has concluded that there was no fraudulent intent in failing to list the mortgages, it need not address the fifth element of proof, namely whether the omission related materially to the Debtor's case.

Plaintiffs have also asserted that the Debtor should be denied a discharge pursuant to Code § 727(a)(5) based on his alleged failure to explain satisfactorily a loss of assets which would otherwise be utilized to meet the Debtor's liabilities. Plaintiffs have the burden of establishing "the disappearance of substantial assets or of unusual transactions." *See Silverstein*, 151 B.R. at 663. It is then incumbent upon the Debtor to explain the loss or deficiency. *See id.*

Plaintiffs contend that Debtor has failed to account for the difference between \$35,000 in personal property listed in the 1992 Statement and the \$1,500 in household goods listed in Schedule B attached to his Petition.

Debtor testified that the \$35,000 was comprised of assets jointly owned by him and his wife and was merely an estimate of their value. Debtor admitted that the \$35,000 was probably an overstated figure. According to the Debtor, after moving out of the Oberon Bluff Property Mrs. Andrews retained her jewelry and also took a certain amount of household goods to furnish the residence at the Dryden Road Property. In addition, there is evidence that beginning in February 1995 certain personal property was auctioned off for approximately \$1,570. No evidence was presented to dispute Debtor's testimony. There was also no suggestion that the Debtor had failed to list any personal property still in his possession. Indeed, according to the

Debtor's counsel objected to the admission of the three exhibits on the basis of relevancy and the Court reserved its decision on their admissibility. Insofar as Plaintiffs' burden of proof is concerned in this proceeding, the Court concludes that the three exhibits are not admissible based on a lack of relevancy.

Debtor he doesn't have anything but a few clothes and personal belongings. The Court finds Debtor's explanation reasonable and credible and concludes that the Plaintiffs have failed to establish by a preponderance of the evidence that the Debtor's explanation of the loss of assets was unsatisfactory and that he should be denied a discharge on that basis.

Based on the foregoing, it is hereby

ORDERED that Plaintiffs' motion seeking to admit Exhibits 8, 9 and 17 is denied on the basis of relevancy; it is further

ORDERED that Debtor's motion to strike the testimony of Hemke on the basis of relevancy is granted; and it is further

ORDERED that Plaintiffs' complaint, insofar as it seeks to have the Debtor denied a discharge pursuant to Code § 727 (a)(4) and (a)(5), is dismissed.

Dated at Utica, New York

this 22nd day of July 1997

STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge